Tax Arbitration:
Protection for Foreign Investors from Unforeseen Tax Claims
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VDB Loi
Senior partner
Edwin Vanderbruggen

Formerly with Loyens & Loeff and a partner at DFDL, Edwin has 20 years of experience as a tax lawyer, academic, author and government adviser. He has worked 15 years in Southeast Asia. Edwin taught international tax law at six different universities in Europe and Asia, including delivering a number of lectures at the prestigious International Tax Center in Leyden. He published seven treatises on international and Asian taxation and over 50 scholarly articles, some winning scientific awards. He is an adviser to the Minister of Economy and Finance of Cambodia on double taxation agreements, and provided training on tax issues to government officials in a number of Southeast Asian countries. Edwin supplied expert testimony to tax courts on tax treaty interpretation, and consulted for the World Bank and the ADB on tax policy and administration.
Can the law of a state levy any tax at all on foreign investors?

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Can States Tax Investors However They Like?

Committments on taxation under international law

1. Commitments in an investment contract -> Tax stabilization clause
2. Commitments in (Bilateral) Investment Treaties (BIT)
   - “Each Contracting Party shall ensure **fair and equitable treatment** of the investments of the nationals of the other Contracting Party”
   - “Neither Contracting Party shall subject investments in its territory owned or controlled by nationals or companies of the other Contracting State to **treatment less favorable than it accords to investments of its own nationals or companies or to investments of nationals or companies of any third state**”.
   - “A State shall **not expropriate** or nationalise a covered investment either directly or through measures equivalent to expropriation or nationalisation (“expropriation”), except: (a) for a public purpose (b) in a non-discriminatory manner; (c) on payment of prompt, adequate, and effective compensation; and (d) in accordance with due process of law”
The Case of the Tax Free Merger
Duke Energy v. Peru

• In 1999 a US energy company called Duke invests in power plants in Peru by purchasing a holding company which holds various operating companies.

• At the end of 1996, one of the operating companies that Duke indirectly acquires had been merged with a newly established company, Newco. The merger took place so that the assets of the power plant could be revalued for tax purposes without however paying any taxes on that revaluation in the company that owned the assets, based on a tax exemption in the “Merger Revaluation Law”.

• In 2001, the Peruvian tax authorities assess taxes on the merger, in essence claiming that the merger was a sham and does not qualify for the tax exemption.

• Duke invokes the “Legal Stability Agreement” that was concluded with Peru for a period of 10 years, which includes a tax stabilization clause.
The Case of the Tax Free Merger
Duke Energy v. Peru

• What is the legal effect of a stabilization clause?

• When is a tax situation “stabilized”?
  • New laws or regulations
  • New interpretation
  • Clear case law or writings
  • Statements from the Government that merely imply a certain interpretation

• Impact of anti-evasion measures?

Outcome: Investor wins the case
The Case of the Duty Free Shop
Link Trading v. Moldavia

• A US company, called Link Trading, operates a duty free retail operation in a Free Economic Zone Moldova has created.

• Customers have the right to buy US$600 worth of duty-free goods in the Free Zone and take these out of the Zone.

• The US$600 limit is later reduced by the authorities and ultimately abolished.

• The company argues this is contrary to the legal stabilization clause that exists for investors in the Free Zone, as created by Moldovan law, and a violation of the relevant Bilateral Investment Treaty (BIT).

• Foreign Investment Law contains a 10 year stabilization clause.

• Free Economic Zone Law has stabilization clause as well.
The Case of the Duty Free Shop
Link Trading v. Moldavia

- The guarantees in domestic law do not apply to these customs rules.
- Tribunal: “Customs regulations are subject to annual change, and the investor should have known that”. Also: “Governments...frequently change their laws and regulations...those changes may well make certain activities less profitable or even uneconomic to continue” (Feldman v Mexico, par. 112)
- “Not dissimilar to the policies of many countries in the world, not abusive, arbitrary or discriminatory”
- “The tax laws are used as instruments of public policy as well as fiscal policy, and certain taxpayers are inevitably favored, with others less favored or even disadvantaged” (Feldman v Mexico par. 113)
- **Are there limits to this sovereign freedom?**

**Outcome: Government wins the case**
The Case of the Oil Company VAT Refund
Occidental v. Ecuador

- In 1999, an oil company called Occidental concludes a Production Sharing Contract (PSC) with Ecuador for the exploration of oil. It contains a tax stabilization clause.

- Between 1999 and 2001, Occidental claims and receives refunds for VAT it incurs on supplies made to the company, such as VAT on drilling services.

- Starting from 2001, the tax authorities refuse refunds and reclaim refunds that were already paid based on the view that VAT refunds are already included in the company’s production share, and that VAT refunds are not possible for oil producing companies as per internal law (“manufacturing for export”).

- Occidental files lawsuits in Ecuador, which are still pending in 2002 when the company starts the arbitration procedure.
The Case of the Oil Company VAT Refund
Occidental v. Ecuador

- “Fork in the road”
- No evidence that VAT refund is in factor X
- “The stability of the legal and business framework is thus an essential element of fair and equitable treatment”.

The Tribunal must note in this context that the framework under which the investment was made and operates has been changed in an important manner by the actions adopted by the [tax authorities]. ... The tax law was changed without providing any clarity about its meaning and extent and the practice and regulations were also inconsistent with such changes”, resulting in a breach of fair and equitable treatment

Outcome: Investor wins the case
The Case of the Cigarette Exporter
Feldman v. Mexico

- A foreign invested company in Mexico called CESMA buys and exports cigarettes. There are only two companies in this business, one foreign and one domestic.
- CESMA is refused excise tax refunds for exported cigarettes while domestic competitors were able to receive the refunds.
- In 1991, the laws were changed to exclude cigarette exporters from refunds, but this was later deemed unconstitutional by the Mexican Supreme Court.
- In 1993, the tax authorities again denied refunds to CESMA this time based on regulations stating the information to be included on invoices that entitle to the refund. These regulations were in place since 1987.
- CESMA is unable to buy from whole-sellers and thus has no such invoices, but argues that these regulations were in practice waived or ignored for domestic cigarette resellers.
The Case of the Cigarette Exporter
Feldman v. Mexico

- Difficulties in dealing with tax officials is not enough: “Unfortunately, tax authorities in most countries do not always act in a consistent and predictable way”
- “Act in accordance with due process and with domestic laws, regulations and internal procedures” (Tza Yup Sum vs. Peru)
- Which international obligations must the tax official observe, and are these different from domestic obligations? Due process, good faith (reasonableness, fair, honest), transparency.

In this case:
- Evidence of discrimination: tax rebates were indeed paid to domestic competitors of CESMA + burden on the Government
- “Mexico is of course entitled to strictly enforce its laws, but it must do so in a non-discriminatory manner”

Outcome: Investor wins the case
The Case of the Transfer Pricing Audit
Tza Yap Shum vs. Peru

- In 2002, Mr. Tza Yap Shum establishes TSG with an investment of US$400,000.
- TSG purchases raw fish, delivers this fish to third-party factories to process it into fish meal, and exports the finished product. Sales reach US$20M per year.
- In 2004, the Peruvian tax authorities “SUNAT” conduct a routine audit of TSG after TSG had requested sales tax refunds.
- TSG has not properly declared the amounts and values of raw materials.
- The SUNAT issued a new tax assessment based on “presumed basis” of 4M$.
- SUNAT “interim measures”: banks in Peru are directed to retain any funds passing them related to TSG and redirect them to the SUNAT.
- TSG’s business becomes inoperable.
- TSG commenced proceedings in Peru to have the tax claim lifted. An appeal to the SUNAT was rejected, although the amount of back taxes was reduced.
- TSG’s challenge before the Peruvian Fiscal Tribunal was rejected as well.
The Case of the Transfer Pricing Audit
Tza Yap Shum vs. Peru

- TSG first maintained that the tax audit itself was an expropriation. The Tribunal did not agree to this. The Tribunal found that the audit appeared to have been routine. Peru has the right to conduct tax audits on enterprises, so the tax audit in and of itself cannot be seen as an expropriation.

- The Tribunal determined that the interim measures taken by the SUNAT did in fact amount to an expropriation.
  - The interim measures significantly interfered with the operation of TSG:
  - SUNAT imposed the interim measures in an arbitrary manner: The SUNAT did not respect the internal rules and guidelines for its own interim measures, which state that these measures are exceptional, need to be justified and accompanied by evidence, and that efforts must be made to mitigate harm to the taxpayer’s business.

Outcome: Investor wins the case
Some Concluding Remarks

• The big questions
• In practice
• Quo vadis?
Are You on My Mailing List?

Salient Details of Myanmar’s New Foreign Investment Law

Edwine Vandebroeghe, Cynthia Herman & Thida Cho Win

A new Foreign Investment Law (FIL) has passed the Union Parliament of Myanmar (the “Parliament”), an important step in Myanmar’s economic revitalization. The FIL sets out many incentives related to Myanmar’s investment environment. As a key part of this framework for designing special areas of economic activity, the incentives and restrictions under the FIL are designed to ensure that foreign investors understand and adhere to the rules. The FIL also contains special rules for foreign parties interested in investing, such as foreign currency transactions, in part because the FIL contains a number of tax holidays and other special benefits tailored to these companies that follow the rules. Finally, the FIL also contains rules that will be used by persons who are not bona fide investors.

We have looked at a just a part of the FIL as passed by the Upper House of the National Assembly. The rest of the law will subject to changes as the National Assembly will reconvene changes proposed by the President. We have commented at this time only on the provisions which were encompassed within the FIL, even after amendments, but cannot be excluded that other provisions will be changed.

Which sectors are covered, which are restricted?

Encouraged Activities

Chapter 3 of the FIL stipulates that the following sectors are encouraged:

- Mining and smelting
- Petroleum and gas processing
- Electric power generation and distribution
- Agriculture, agro-processing, and related activities
- Food processing
- Construction and real estate development
- Tourism and hospitality
- Information technology, communication, and digital services
- Tourism promotion, advertising, and marketing
- Education and training
- Sports and recreation
- Environmental protection and waste management
- Health services
- Social services
- Culture and arts
- Artisan and craft production
- Art and cultural heritage

About the Authors

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VDB Loi in the News

Are You on My Mailing List?: Questions on the Myanmar Taxation of Oilfield Services under its Double Taxation Agreements with Malaysia, Singapore and Thailand

Edwine Vandebroeghe, Cynthia Herman & Thida Cho Win

This analysis focuses on the international tax treatment of oil and gas field services income derived from Myanmar, with particular reference to services performed from a newly created hub in the region, notably the oil producing states in Malaysia, Singapore and Thailand. All these jurisdictions have tax treaties referred to as “Double Taxation Agreements” or “DTA’s” in force with Myanmar.

Myanmar has considerable reserves of crude oil and natural gas, estimated at 2.1 billion barrels of oil and 25 trillion cubic feet of gas. According to an energy ministry publication in June 2017, interest remains high in the development of Myanmar’s oil and gas fields. In July 2019, nine auction blocks were awarded to oil companies from various countries, including China National Petroleum Corporation, Geopetrol from Switzerland, EM Holding Ltd from Hong Kong, India’s Reliance Industries, and Thailand’s PTTPL. With 80 countries participating and USD 1.2 billion on investment, the potential for the remaining blocks, which include 22 new offshore blocks, remains high.

About the Authors

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